

SEC Announces Compliance Date for Pay-to-Play Rule

Despite the July 31, 2015 compliance date, the SEC will not enforce the third-party solicitation ban until corresponding FINRA/MSRB Rules take effect.

On June 25, 2015, the Securities and Exchange Commission (SEC) announced a compliance date of July 31, 2015 for the provision of its Pay-to-Play Rule under the Investment Advisers Act of 1940 that requires third-party solicitors be subject to a similar pay-to-play regime.¹ Some had thought that the SEC would require compliance with the third-party solicitation ban² as early as April 1, 2015.³ While the SEC has now established the compliance date at the end of this month, it also provided guidance that will allow time for the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) to finalize their own pay-to-play rules.

The SEC guidance is in the form of updated FAQs and states that “[u]ntil the **later** of (i) the effective date of such a FINRA pay to play rule or (ii) the effective date of such an MSRB pay to play rule, the Division would not recommend enforcement action to the Commission against an investment adviser or its covered associates under rule 206(4)-5(a)(2)(i) for the payment to any person to solicit a government entity for investment advisory services.”⁴ Accordingly, advisers and broker-dealers can take some comfort that they may continue their business uninterrupted during the period before the effective dates of the FINRA and MSRB rules.

The SEC Pay-to-Play Rule⁵ prohibits an investment adviser and its covered associates from providing or agreeing to provide payment, directly or indirectly, to any third party to solicit a government entity for investment advisory services on behalf of such investment adviser unless such third-party is an SEC-registered investment adviser, a FINRA member subject to FINRA pay-to-play rules, or a registered municipal advisor subject to pay-to-play rules adopted by the MSRB.⁶ The Pay-to-Play Rule also provides that the FINRA and MSRB pay-to-play rules must impose “substantially equivalent or more stringent restrictions on broker-dealers than [the SEC Pay-to-Play Rule] imposes on investment advisers and ... [must be] consistent with the objectives of [the SEC Pay-to-Play Rule].”⁷

On August 18, 2014, the MSRB proposed amendments to its longstanding pay-to-play rule, Rule G-37, to expand its coverage to municipal advisors, and has since received a number of comment letters.⁸

FINRA released its proposed pay-to-play rules on November 14, 2014,⁹ and while the FINRA Proposed Rules are similar in most respects to the SEC Pay-to-Play Rule, there are two notable and controversial differences where the FINRA Proposed Rules are more stringent. First, the Proposed Rule 2271 imposes additional disclosure requirements that would require members to make specified disclosures to government entities in writing at the time of the initial distribution or solicitation. Second, the Proposed Rule 2390 includes a disgorgement requirement that would prevent a member from retaining

compensation or other remuneration in connection with activities that are contrary to the requirements of the FINRA Proposed Rules.

In response to the FINRA Proposed Rules, commenters have been highly critical of the additional disclosure requirements in Proposed Rule 2271, stating for example that “not only would [the disclosure requirement] be so burdensome as to be unworkable for the covered member, government entities across the country would be inundated with duplicative and essentially meaningless disclosure documents from every covered member with whom they do business.”¹⁰

We understand that FINRA is considering re-proposing the rules based on the comments that it has received and that FINRA anticipates issuing revised pay-to-play rules in the near future.

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Endnotes

- ¹ See Investment Advisers Act Release No. 4129, *available at* <https://www.sec.gov/rules/other/2015/ia-4129.pdf>
- ² 17 C.F.R. 275.206(4)-5.
- ³ See FINRA Regulatory Notice 14-50 (November 14, 2014), *available at* https://www.finra.org/sites/default/files/notice_doc_file_ref/14-50.pdf.
- ⁴ See Staff Responses to Questions About the Pay to Play Rule at Question I.4 (June 25, 2015), *available at* <https://www.sec.gov/divisions/investment/pay-to-play-faq.htm>.
- ⁵ 17 C.F.R. 275.206(4)-5.
- ⁶ 17 C.F.R. 275.206(4)-5(a)(2)(i).
- ⁷ 17 C.F.R. 275.206(4)-5(f)(9)(ii).
- ⁸ See MSRB Regulatory Notice 2014-15 (August 18, 2014), *available at* <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2014-15.ashx>.
- ⁹ FINRA Regulatory Notice 14-50 is a request for comments on three proposed rules: Rule 2271 (Disclosure Requirement for Government Distribution and Solicitation Activities), Rule 2390 (Engaging in Distribution and Solicitation Activities with Government Entities) and Rule 4580 (Books and Records Requirements for Government Distribution and Solicitation Activities) (collectively, the FINRA Proposed Rules).
- ¹⁰ See SIFMA Comment regarding Regulatory Notice 14-50 (December 22, 2014) *available at* https://www.finra.org/sites/default/files/notice_comment_file_ref/SIFMA%20-%20Comments%20on%20Regulatory%20Notice%2014-5_0.pdf.